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No. 07-

IN THE

Supreme Court of the United States

T-MOBILE USA, INC., OMNIPOINT COMMUNICATIONS, INC. D/B/A T-MOBILE, AND TMO CA/NV, LLC,
Petitioners,

v.

JENNIFER L. LASTER, ANDREW THOMPSON, ELIZABETH VOORHIES, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED AND ON BEHALF OF THE GENERAL PUBLIC,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether, under the Federal Arbitration Act, a federal court may refuse to enforce the terms of an agreement to arbitrate based upon a state-law policy that individual arbitration is unconscionable in cases involving small claims by a consumer.

LIST OF PARTIES AND AFFILIATES

In addition to the parties listed in the caption, the following also were involved in the proceedings below: Verizon Communications, Inc., Cellco Partnership d/b/a Verizon Wireless, Verizon Wireless (VAW) LLC, Airtouch Cellular, Cingular Wireless LLC, Go Wireless, and New Cingular Wireless PCS d/b/a Cingular Wireless.

Pursuant to Rule 29.6 of the Rules of this Court, petitioner T-Mobile USA, Inc. is a wholly-owned subsidiary of T-Mobile Global Holding GmbH, which is a wholly owned subsidiary of T-Mobile International AG, which, in turn, is a wholly owned subsidiary of Deutsche Telekom AG. Deutsche Telekom AG is a publicly traded company, of which approximately 14.83% and 16.87% is owned by the Federal Republic of Germany and the Kreditanstalt für Wiederaufbau (a bank controlled by the Government of the Federal Republic of Germany), respectively. No other publicly-held company owns 10% or more of T-Mobile USA, Inc.

Petitioner Omnipoint Communications, Inc. is a wholly-owned subsidiary of T-Mobile USA, Inc.

Petitioner TMO CA/NV, LLC, is a wholly-owned subsidiary of TMO CA/NV Holdings LLC. TMO CA/NV Holdings LLC is a wholly-owned subsidiary of Omnipoint Communications, Inc., which, as noted, is a wholly-owned subsidiary of T-Mobile USA, Inc.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners T-Mobile USA, Inc., OmniPoint Communications, Inc. d/b/a T-Mobile, and TMO CA/NV, LLC (collectively, "T-Mobile") respectfully request that this Court grant the petition for a writ of certiorari to review the decision and judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the Ninth Circuit is unreported and is reproduced in the Appendix to this Petition ("Pet. App.") at 1a to 3a. The decision of the District Court denying T-Mobile's motion to compel arbitration is published at 407 F. Supp. 2d 1181 (S.D. Cal. 2005), and is reproduced at Pet. App. 4a-33a.

JURISDICTION

This lawsuit originally was filed in California Superior Court and was removed to federal court in May 2005. Plaintiff Jennifer Laster thereafter filed an amended complaint invoking federal jurisdiction based upon diversity of citizenship under the Class Action Fairness Act of 2005. The district court had jurisdiction under 28 U.S.C. §§ 1332(d) and 1453(b). The Ninth Circuit had appellate jurisdiction over the district court's denial of T-Mobile's motion to compel arbitration under 9 U.S.C. § 16(a)(1). This Court has jurisdiction over this petition for review of the Ninth Circuit's October 25, 2007 decision under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Sections 2 and 4 of the Federal Arbitration Act ("FAA") are reproduced in the Appendix at Pet. App. 34a-35a.

STATEMENT OF THE CASE

This case presents the recurring question whether Section 2 of the FAA permits federal courts to refuse to enforce agreements to arbitrate claims individually based on a state-law policy that individual arbitration of consumer claims is substantively unconscionable. Respondent Jennifer Laster purchased a T-Mobile phone and entered into a written agreement to resolve disputes with T-Mobile through individual arbitration. Notwithstanding that agreement, Laster filed a class action on behalf of herself and all similarly situated California consumers claiming that T-Mobile violated California law by charging California sales tax on the full retail value of discounted wireless telephones. The court below, applying prior Ninth Circuit and California Supreme Court precedent in *Shroyer* v. *New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007), and *Discover Bank* v. *Superior Court*, 113 P.3d 1100 (Cal. 2005), held that Laster's arbitration agreement with T-Mobile was unenforceable because it provided for individual and not class-wide arbitration.

The Ninth Circuit's decision is in direct conflict with the Third Circuit's ruling in *Gay* v. *CreditInform*, ___ F.3d ___, 2007 WL 4410362 (3d Cir. Dec. 19, 2007). Indeed, the Ninth Circuit has expressly declined "to follow the Third Circuit's holding in *Gay*." *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *8 n.3 (9th Cir. Jan. 22, 2008). In *Gay*, the Third Circuit, relying on this Court's decision in *Perry* v. *Thomas*, 482 U.S. 483 (1987), has ruled that the FAA precludes a court from refusing to enforce an agreement to arbitrate individually based upon a state-law determination that individual arbitration of small consumer claims is unconscionable. 2007 WL 4410362, at *20. The

Gay Court concluded that state unconscionability standards are preempted to the extent that they would render individual arbitration unenforceable. Denying enforcement on those grounds, the *Gay* Court explained, would be tantamount to "'rely[ing] on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable.'" *Id.* (quoting *Perry*, 482 U.S. at 492 n.9).

The *Gay* decision, in turn, builds on decisions by other federal circuits holding that individual arbitration is enforceable under the FAA as an entirely appropriate mechanism for resolving federal and state claims by consumers in cases involving relatively small individual amounts. See *Johnson* v. *West Suburban Bank*, 225 F.3d 366, 373 (3d Cir. 2000); *accord Jenkins* v. *First Am. Cash Advance of Ga., LLC*, 400 F.3d 868 (11th Cir. 2005), *cert. denied*, 546 U.S. 1214 (2006); *Livingston* v. *Associates Fin., Inc.*, 339 F.3d 553 (7th Cir. 2003); *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Randolph* v. *Green Tree Fin. Corp.*, 244 F.3d 814 (11th Cir. 2001). These courts hold that the FAA mandates enforcement of individual arbitration of claims by consumers notwithstanding the absence of class-wide procedures.

The instant case squarely implicates this conflict over the enforceability of agreements to arbitrate consumer claims individually. In the ruling below, the Ninth Circuit applied *Shroyer* to hold that the FAA does not mandate enforcement of these agreements. Pet. App. 2a-3a. In contrast, the Third Circuit in *Gay* ruled that the FAA does mandate enforcement of agreements requiring individual arbitration of consumer claims, and thus preempts state law to the contrary. Moreover, the Third,

Fourth, Seventh, and Eleventh Circuits all have held – unlike the decision below – that individual arbitration allows for the effective resolution of claims in cases involving consumers.

Resolution of this conflict is necessary because the proper application of the FAA to consumer arbitration agreements presents a recurring issue of fundamental and national importance. The enforceability of agreements to arbitrate under the FAA is a matter that affects the rights of tens of millions of consumers and businesses. Indeed, a state-law rule that arbitration must provide class-wide procedures directly undercuts the benefit of arbitration as a streamlined, low-cost *alternative* to litigation. Decisions by courts that invalidate the terms of these arbitration agreements directly undermine the "primary purpose" of the FAA: to counteract judicial hostility to arbitration and to ensure that arbitration remains a viable alternative to litigation through enforcement of agreements to arbitrate in accordance with their terms. See *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989); 9 U.S.C. § 4.

Review is warranted so that the proper application of the FAA and the rights of tens of millions of individuals and businesses are not made to depend upon geography or on the prevailing construction of the FAA within an individual state or federal circuit.

STATUTORY BACKGROUND

In 1925, Congress enacted the FAA in response "to hostility of American courts to the enforcement of arbitration agreements." *Circuit City Stores* v. *Adams*, 532 U.S. 105, 111 (2001). Congress sought to promote arbitration as a meaningful alternative to litigation. "[B]y agreeing to arbitrate, a party 'trades

the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'" *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991). Indeed, "it is typically a desire to keep the effort and expense required to resolve a dispute within manageable bounds that prompts [parties] to forgo access to judicial remedies." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985). For that reason, "Congress, when enacting [the FAA], had the needs of consumers, as well as others, in mind." *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 280 (1995).

The "primary purpose" of the FAA is to "ensur[e] that private agreements to arbitrate are enforced according to their terms." *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989). Arbitration agreements must be "rigorously enforce[d]" even if "the result is 'piecemeal' litigation." *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 221 (1985). Indeed, Section 2 of the FAA "compels judicial enforcement of a wide range of written arbitration agreements," *Circuit City*, 532 U.S. at 111, "'notwithstanding any state substantive or procedural policies to the contrary.'" *Perry* v. *Thomas*, 482 U.S. 483, 489 (1987) (quoting *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

Under the FAA, "the underlying issue of arbitrability" is "a question of substantive federal law," *Southland Corp.* v. *Keating*, 465 U.S. 1, 12 (1984), that "must be addressed with a healthy regard for the federal policy favoring arbitration," *Moses H. Cone*, 460 U.S. at 24. In determining whether an agreement to arbitrate is enforceable, "the text of § 2 provides the touchstone for choosing between state-law principles and the principles of

federal common law." *Perry*, 482 U.S. at 492 n.9. As explained in *Perry*, "[a]n agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law* 'save upon such grounds as exist at law or in equity for the revocation of *any* contract.'" *Id.* (quoting 9 U.S.C. § 2) (internal citation omitted; emphasis added by Court). "[S]tate law . . . is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Id.* at 493 n.9.

"Courts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." *Doctor's Assocs. Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996); see *Perry*, 482 U.S. at 493 n.9. Likewise, courts may not (i) refuse enforcement based on state laws applicable only to certain types or categories of contracts, *Southland*, 465 U.S. at 16 n.11, or (ii) rely upon a fundamental aspect of arbitration as a basis for a ruling that arbitration is unconscionable, *Perry*, 482 U.S. at 493 n.9.

FACTUAL BACKGROUND

Petitioner T-Mobile markets and sells wireless telecommunications services, phones, and accessories throughout the United States. T-Mobile, which currently has more than 28 million customers, uses standardized contracts because it cannot realistically negotiate separate terms and conditions with each of these customers. Of course, no consumer is compelled to buy T-Mobile's service or accept its terms and conditions given the highly competitive market for wireless service.

a. Wireless service and phones often are sold together in "bundled" transactions, in which consumers receive a free or significantly discounted

phone in exchange for agreeing to wireless service contracts for a term of one or two years. When T-Mobile offers a free or discounted phone as part of a bundled transaction, some states (such as California) require that T-Mobile charge sales tax based on the full retail value of the phone.

On February 23, 2005, Plaintiff Laster purchased a wireless phone and wireless service at a T-Mobile store in San Diego, California. Pet. App. 8a-9a. As part of that transaction, Laster received the phone at no cost. California law requires that sales tax be paid on the full retail value of the phone when the sale is part of a bundled transaction. See Cal. Code Regs. tit. 18, § 1585(a)(4), (b)(3). These taxes were reflected on Laster's receipt, which showed that she was charged $28.22 in sales tax (based upon the $364.13 retail value of the phone). She paid the sales tax. Pet. App. 9a. Indeed, Laster admitted in her Complaint that when she made her purchase, her receipt disclosed the amount of tax and that "'[b]y law, some states impose a tax based on the retail price or cost of our product instead of the discounted price.'" First Am. Compl. ¶ 23 (9th Cir. Excerpts of Record ("ER") at 44).

At the time of her purchase, Laster also signed a Service Agreement and agreed to terms and conditions including "MANDATORY ARBITRATION." Pet. App. 9a; ER 123. Accompanying Laster's new phone was the T-Mobile Welcome Guide, which set forth in full the terms and conditions of service. The first paragraph advised, "IF YOU DON'T AGREE WITH THESE [TERMS AND CONDITIONS], DO NOT USE THE SERVICE OR YOUR UNIT." ER 109. The Agreement provided her with 30 days to cancel her service with no further obligation and return her phone for a full refund. ER

109. The trial period also was disclosed on Laster's sales receipt. ER 81. Laster chose to keep her phone, to continue her T-Mobile service, and to accept the corresponding terms and conditions. See ER 77.

Section 3 of the Terms and Conditions sets forth an arbitration agreement, which provides that it is governed by "the Federal Arbitration Act and federal arbitration law":

> Mandatory Arbitration: Dispute Resolution. YOU WILL FIRST NEGOTIATE WITH US IN GOOD FAITH TO SETTLE ANY CLAIM OR DISPUTE BETWEEN YOU AND US IN ANY WAY RELATED TO OR CONCERNING THE AGREEMENT, OR OUR PROVISION TO YOU OF GOODS, SERVICES, OR UNITS ("CLAIM"). . . . IF YOU DO NOT REACH AGREEMENT WITH US WITHIN 30 DAYS, INSTEAD OF SUING IN COURT, YOU AGREE THAT ANY CLAIM MUST BE SUBMITTED TO FINAL, BINDING ARBITRATION . . . .
>
> Neither you nor we may be a representative of other potential claimants or a class of potential claimants in any dispute, nor may two or more individuals' disputes be consolidated in one proceeding. . . . YOU AND WE ACKNOWLEDGE AND AGREE THAT THIS SEC. 3 WAIVES ANY RIGHT TO A JURY TRIAL OR PARTICIPATION AS A PLAINTIFF OR AS A CLASS MEMBER IN A CLASS ACTION.

Pet. App. 36a-37a (capitalization in original). The arbitration agreement further provides that the arbitrator can award Laster the same relief and remedies as a court, and that T-Mobile would pay all of the arbitrator fees for claims under $25, and all arbitrator fees, except $25, for claims valued between

$25 to $1000. *Id.* Finally, the arbitration agreement provided that Laster could seek relief in small claims court. *Id.* The arbitration agreement is reproduced at Pet. App. 36a-38a.

b. Notwithstanding this agreement, in May 2005, Laster filed a class action in California state court. Her lawsuit advanced three causes of action arising from her purchase of a wireless phone and service.

First, she claimed that T-Mobile was liable under California's False Advertising Law, Cal. Bus. & Prof. Code § 17500. According to the First Amended Complaint, T-Mobile and other defendants "failed to adequately disclose the fact that sales tax would be charged on the full value of the phone," and where disclosure was made, as it was in Laster's case, "the type-size, font, and location of the disclosure" were inadequate. First Am. Compl. ¶ 36 (ER 48). Second, Laster claimed that T-Mobile violated California's Consumer Legal Remedies Act, Cal. Civ. Code § 1780, because its advertising with respect to her phone was an unfair method of competition and an unfair or deceptive act or practice. First Am. Compl. ¶ 42 (ER 49). Finally, Laster sought recovery under California's Unfair Competition Law, Cal. Bus. & Prof. Code § 17200. First Am. Compl. ¶ 48 (ER 50). In connection with these claims, Laster sought injunctive relief, restitution, compensatory damages, "punitive damages," and "all attorneys' fees and litigation expenses." *Id.* ¶¶ 44-46, 53 (ER 50, 53).

c. After removal to federal court, T-Mobile moved to compel arbitration under the FAA. Pet. App. 5a. The district court denied that motion, ruling first that the arbitration agreement was contained in a form contract, and was therefore, *per se*, procedurally unconscionable. *Id.* at 15a-16a.

Relying on the California Supreme Court's decision in *Discover Bank* v. *Superior Court*, 113 P.3d 1100 (Cal. 2005), the district court also ruled that the agreement was substantively unconscionable because it required individual arbitration – *i.e.*, it did not allow class-wide arbitration. The district court explained that under *Discover Bank*, "a classwide arbitration bar is unconscionable" if: "(1) the class action waiver is contained in a consumer contract of adhesion, in which small amounts of damages are at issue; and (2) it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money." Pet. App. 20a.

Because plaintiff Laster alleged claims that involved individually "small amounts of money," and because she alleged (despite disclosures, including on her sales receipt, that she knew she was paying the tax) that charging consumers sales tax on the full retail value of the phone was a "scheme to mislead consumers," the district court concluded that Laster had satisfied the *Discover Bank* test. Pet. App. 20-21a. The district court dismissed as irrelevant evidence that plaintiffs had significant incentives to arbitrate their individual claims because, if successful, they would be entitled to attorneys' fees and costs. *Id.* at 21a-22a.

Finally, the district court adopted the conclusion from *Discover Bank* that the FAA did not preempt California law refusing to enforce individual arbitration because that court had invoked state unconscionability law. Pet. App. 24a. The court ruled that "unconscionability . . . may be employed as a principle of general applicability to invalidate an arbitration agreement without contravening § 2 of the FAA." *Id.*

d. The Ninth Circuit affirmed. It concluded, in an unpublished per curiam decision, that T-Mobile's arbitration agreement was "not substantively distinguishable" from an agreement that the Ninth Circuit had previously refused to enforce in *Shroyer* v. *New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007). Pet. App. 2a. The panel below explained that *Shroyer* "rejected the argument that California law is preempted by the Federal Arbitration Act" and that it lacked "the authority to revisit the decision of a prior three-judge panel." *Id.* at 3a.

Specifically, in *Shroyer*, Judge Reinhardt, joined by Judges Nelson and Rymer, adopted the California Supreme Court's state-law unconscionability analysis in *Discover Bank*. *Shroyer* further held that the ability of a party to recover attorneys' fees and arbitration costs in individual arbitration did not alter the conclusion that individual arbitration was unconscionable under California law. 498 F.3d at 986. Finally, as to preemption under the FAA, the *Shroyer* Court adopted *Discover Bank*'s analysis and held that the FAA "does not bar federal or state courts from applying generally applicable state contract law principles and refusing to enforce an unconscionable class action waiver in an arbitration clause." *Id.* at 987.

REASONS FOR GRANTING THE PETITION

Review is warranted because this case squarely implicates a conflict on an important and recurring issue of federal law: Whether the FAA requires enforcement of agreements to arbitrate consumer disputes on an individual basis, or whether such agreements can be invalidated based on state-law policy in favor of class actions.

The California Supreme Court in *Discover Bank*, followed by the Ninth Circuit in *Shroyer* and other state supreme courts, have held that the FAA permits them to refuse to enforce the terms of agreements to arbitrate based on a state-law determination that the absence of class-action procedures available in litigation is "unconscionable." In stark contrast, the Third Circuit in *Gay* has ruled that to the extent state law holds that arbitration agreements are unconscionable because they lack class-wide procedures, then state law must give way to the requirements of the FAA. Since then, the Ninth Circuit has considered, but "declined to follow the holding in *Gay*." *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *8 n.3 (9th Cir. Jan. 22, 2008). In contrast, other circuits have held that individual arbitration agreements involving claims by consumers must be enforced under the FAA. See *supra* at 3.

Further, the ruling below conflicts with this Court's decisions such as *Perry* v. *Thomas*, which ruled that a court may not rely upon the "uniqueness" of arbitration to hold that an arbitration agreement is "unconscionable." 482 U.S. 483, 493 n.9 (1987). This Court has explained that the FAA was enacted to ensure that arbitration remains a meaningful *alternative* to litigation. That is why the FAA requires not simply enforcement of arbitration, but enforcement of arbitration in accordance with the terms agreed to by the parties. See *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989); 9 U.S.C. § 4.

The decision below threatens the continued viability of agreements to arbitrate in a broad range of consumer transactions. The benefits of arbitration as an alternative to litigation are lost when state law

requires that the procedures agreed to by parties in their contracts must give way to the more formal, expensive and time-consuming procedures found in courtroom litigation. Under the FAA, a state-law requirement that arbitration must replicate courtroom litigation is preempted.

Here, the arbitration agreement was deemed unenforceable even though (i) T-Mobile agreed to pay virtually all arbitrator costs, (ii) plaintiff could recover attorneys' fees if she prevailed on her claims, and (iii) plaintiff retained the option of filing suit in small claims court. Nevertheless, individual arbitration was ruled unenforceable because the parties agreed to an alternative to the complex, costly and time-consuming class-wide procedures in litigation and declined to subject their agreement to the "greater degree of court involvement" and "external supervision" necessary to implement class arbitration. *Discover Bank* v. *Superior Court*, 113 P.3d 1100, 1106 (Cal. 2005) (internal quotes omitted).

Resolution of this dispute is critical to the proper and uniform application of the FAA to the rights of tens of millions of consumers and businesses throughout the country. Individual dispute resolution lies at the heart of agreements to arbitrate that have been adopted by consumers and businesses across the country, including for banking, credit cards, internet sales, cable television, and wireless and wireline phone services. The decision below, however, threatens to undermine the ability of consumers and businesses to reject the delay and expense of traditional litigation in favor of "the simplicity, informality, and expedition of arbitration." *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991).

If arbitration under the FAA is to remain a meaningful alternative to litigation, state law should not be permitted to bar enforcement of agreements to arbitrate simply because they do not provide for the same procedures associated with litigation. To require that arbitration mirror litigation in this fashion is nothing less than the "judicial hostility" that Congress intended to eliminate through the FAA.

I. THE DECISION BELOW IMPLICATES A CONFLICT AMONG STATE AND FEDERAL COURTS OVER THE ENFORCEABILITY OF INDIVIDUAL ARBITRATION UNDER THE FAA.

This case presents a conflict on the recurring question whether, under the FAA, courts may refuse to enforce private agreements to arbitrate that require individual resolution of claims by consumers. Resolution of this conflict is necessary to ensure that the rights of tens of millions of individuals and businesses are not made to depend on the prevailing interpretation of the FAA in a particular state or federal circuit.

a. The decision below adopts the analysis set forth by the Ninth Circuit in *Shroyer*, 498 F.3d 976, which, in turn, adopts the California Supreme Court's decision in *Discover Bank*, 113 P.3d 1100. Both *Shroyer* and *Discover Bank* hold that the FAA does not mandate enforcement of form agreements with consumers calling for individual arbitration. Pet. App. 2a-3a.

In *Discover Bank*, the California Supreme Court held that "at least in some circumstances, . . . class action waivers in consumer contracts of adhesion are unenforceable, whether the consumer is being asked

to waive the right to class action litigation or the right to classwide arbitration." 113 P.3d at 1103. That court further held that the FAA does not "preempt[] California law in this respect." *Id.*

In reaching that conclusion, the *Discover Bank* Court acknowledged that class-wide arbitration necessarily requires a "greater degree of court involvement" than traditional arbitration, and, in fact, was better characterized as a "*hybrid procedure* of classwide arbitration." *Id.* at 1106 (emphasis added). Under that "hybrid procedure," a "court would have to make initial determinations regarding certification and notice to the class, and if classwide arbitration proceeds it may be called upon to exercise a measure of external supervision in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement." *Id.* (quoting *Keating* v. *Superior Court*, 645 P.2d 1192, 1209 (Cal. 1982)). Nevertheless, the "judicial intrusion" into private arbitration was appropriate, the court concluded, given the "important role of class action remedies in California law." *Id.*

Discover Bank disagreed with the rulings by other courts that the "potential availability of attorney fees to the prevailing party in arbitration or litigation ameliorates the problem posed by such class action waivers." *Id.* at 1109-10. In particular, the court rejected the Fourth Circuit's conclusion that the availability of attorneys' fees or other forms of redress, including "informal resolution," were "adequate substitute[s]" for the "class action or arbitration mechanism." *Id.* at 1110 (disagreeing with *Snowden* v. *Checkpoint Check Cashing*, 290 F.3d 631, 638 (4th Cir. 2002)).

Finally, the court rejected the argument that the FAA mandated enforcement notwithstanding contrary state policies in favor of class actions because "the FAA does not federalize the law of unconscionability or related contract defenses except to the extent that it forbids the use of such defenses to discriminate against arbitration clauses." *Id.* at 1112-13. Because California law favored class-wide litigation of certain consumer claims, the court concluded that imposition of a similar preference in favor of class-wide arbitration reflected no "discrimination" against arbitration. *Id.* at 1113.

The Ninth Circuit embraced *Discover Bank*'s analysis in *Shroyer* v. *New Cingular Wireless Servs., Inc.*, 498 F.3d 976 (9th Cir. 2007). Writing for the panel, Judge Reinhardt applied *Discover Bank*'s test and found that a class waiver in an arbitration agreement was unconscionable under California law to resolve the claims of a plaintiff who sought to represent a class of wireless phone consumers. *Id.* at 984-86. In doing so, the Ninth Circuit rejected Cingular's argument that its agreement to arbitrate "does not deter customers from arbitrating individual small-value claims" or "insulate Cingular from liability" even though Cingular had agreed to pay the full costs of arbitration and permitted recovery of attorneys' fees. *Id.* at 986.

Finally, the *Shroyer* court rejected the argument that the FAA preempted a finding that the agreement to arbitrate was unenforceable because it concluded that, as a blanket matter, "'unconscionability is a generally applicable contract defense [that] may be applied to invalidate an arbitration agreement without contravening § 2 of the FAA.'" *Id.* at 988 (quoting *Ting v. AT&T Corp.*, 319 F.3d 1126, 1150 n.15 (9th Cir. 2003)).

The First Circuit has likewise followed *Discover Bank* in ruling that an agreement to arbitrate individually was unenforceable with respect to federal and state antitrust claims because it denied consumers class-wide procedures. See *Kristian* v. *Comcast Corp.*, 446 F.3d 25, 59 (1st Cir. 2006). In doing so, the First Circuit held that enforceability of agreements to arbitrate is an issue of federal law because "state contract law doctrines, by operation of the FAA, become part of the federal substantive law of arbitrability." *Id.* at 63.

A number of state courts of last resort have followed *Discover Bank*'s and *Shroyer*'s basic approach to the enforcement of arbitration agreements under the FAA. Most recently, in *Scott* v. *Cingular Wireless*, 161 P.3d 1000 (Wash. 2007) (en banc), Washington's Supreme Court held that *all* class waivers in consumer arbitration agreements are unenforceable because "class actions are a critical piece of the enforcement of consumer protection law." *Id.* at 1006. The *Scott* Court also followed *Discover Bank* in holding that state law "striking a class action waiver in an arbitration clause does not violate the FAA." *Id.* at 1008.[1]

Three Justices dissented in *Scott*. They concluded that the majority approach "disfavors arbitration, contradicting the strong legislative public policy favoring arbitration of disputes embodied in the

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[1] Applying *Scott*, the Ninth Circuit has held that "T-Mobile's class action waiver is substantively unconscionable, and unenforceable, under Washington law," *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *5 (9th Cir. Jan. 22, 2008), and that the FAA "does not preempt Washington's unconscionability law," *id.* at *7. In doing so, the Ninth Circuit was presented with and declined "to follow the Third Circuit's holding in *Gay*." *Id.* at *8.

Federal Arbitration Act." *Id.* at 1009 (Madsen, J., dissenting). The dissenters concluded that the "refusal to enforce this agreement as written is, without any doubt whatsoever, contrary to the federal policy favoring arbitration" and contrary to "the many courts that have rejected arguments that class action waivers are substantively unconscionable." *Id.* at 1014 (citing cases).[2]

b. In direct conflict with these cases, the Third Circuit in *Gay* v. *CreditInform*, ___ F.3d ___, 2007 WL 4410362 (3d Cir. Dec. 19, 2007), has ruled that state unconscionability law is preempted by the FAA to the extent that it would render individual arbitration of consumer claims unenforceable.

In *Gay*, a Pennsylvania consumer who had entered into a contract to purchase "credit repair services" challenged the provision of her agreement that required mandatory arbitration of any dispute "on an individual basis not consolidated with any other claim." *Id.* at *2. In spite of this agreement, Gay filed a class action advancing claims under the federal Credit Repair Organizations Act and the Pennsylvania Credit Services Act. *Id.* at *1. The district court compelled arbitration of Gay's claims.

On appeal, the Third Circuit affirmed. The court of appeals emphasized that "'[f]ederal law determines whether an issue governed by the FAA is referable to arbitration.'" *Id.* at *14 (alteration in original) (quoting *Harris* v. *Green Tree Fin. Corp.*, 183 F.3d

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[2] *See also Muhammad* v. *County Bank*, 912 A.2d 88, 99 (N.J. 2006) (following *Discover Bank* and holding that agreements to arbitrate individually were unconscionable and unenforceable under Section 2 of the FAA), *cert. denied*, 127 S. Ct. 2032 (2007); *accord Coady* v. *Cross Country Bank*, 729 N.W.2d 732 (Wis. Ct. App.), *review denied*, 737 N.W.2d 432 (Wis. 2007).

173, 178 (3d Cir. 1999)). As a "matter of pure federal common law," the court saw "no reason to conclude that the arbitration provision is unconscionable." *Id.* at *17 n.14. The Third Circuit acknowledged, however, that "two Superior court panels recognized that under Pennsylvania law, class actions are . . . of great public importance as the essential vehicle for vindicating consumer rights." *Id.* at *19 (citation and internal quotation marks omitted). The court explained, however, that "those cases are hardly the end point of our unconscionability analysis because we are concerned with the federal law that Congress set forth in the FAA; the federal law is controlling here and Pennsylvania law must conform with it." *Id.*[3]

Indeed, under binding precedent, "[w]hatever the benefits of class actions, the FAA 'requires piecemeal resolution when necessary to give effect to an arbitration agreement.'" *Id.* at *20 (alternation in original, emphasis omitted) (quoting *Moses H. Cone*, 460 U.S. at 20). The Third Circuit explained that although the "Pennsylvania cases are written ostensibly to apply general principles of contract law, they hold that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate." *Id.* Specifically, Pennsylvania unconscionability law was preempted by the FAA because the state decisions improperly "'rely on the unique-

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[3] The court also concluded that, under Virginia law, an agreement to "arbitrate disputes on an individual basis" does not "constitute an unconscionable bargain," *Gay*, 2007 WL 4410362, at *17, because even where plaintiffs "'lack the procedural right to proceed as part of a class, they retain the range of rights' created by the relevant statute . . . 'in individual arbitration proceedings.'" *Id.* (quoting *Johnson*, 225 F.3d at 373).

ness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable.'" *Id.* (quoting *Perry*, 482 U.S. at 492 n.9).

As a result, the Third Circuit ruled that it would not "apply state law" because to do so would "interfere with the appropriate application of the FAA." *Id.* at *21. The *Gay* Court noted that a contrary conclusion could extend "to arbitration provisions in all sorts of contracts between vendors of goods and services on the one hand and consumers on the other hand" and thus "result in a significant narrowing of the application of the FAA." *Id.* The Third Circuit rejected that course because "[i]f the reach of the FAA is to be confined then Congress and not the courts should be the body to do so." *Id.*[4]

Other federal circuits likewise have rejected the conclusion that individual arbitration denies consumers the ability effectively to vindicate their statutory claims even in cases involving relatively small amounts. The analysis by these federal courts conflicts directly with the California Supreme Court's and Ninth Circuit's conclusions that individual

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[4] The Seventh Circuit has voiced similar skepticism about the use of "unconscionability" as a means for avoiding arbitration under the FAA. *See Oblix, Inc.* v. *Winiecki*, 374 F.3d 488, 491-92 (7th Cir. 2004) (rejecting on FAA grounds unconscionability challenge to arbitration agreement under California law because the state "routinely enforces limited warranties and other terms found in form contracts" and "[i]f a state treats arbitration differently, and imposes on form arbitration clauses more or different requirements from those imposed on other clauses, then its approach is preempted by § 2 [of the FAA]").

arbitrations are ineffective in resolving small claims by consumers.[5]

Thus, the Eleventh Circuit has held that a class waiver is not substantively unconscionable in a lawsuit involving claims based on small personal loans under federal law and Georgia RICO law. *Jenkins* v. *First Am. Cash Advance of Ga., LLC*, 400 F.3d 868, 878 (11th Cir. 2005), *cert. denied*, 546 U.S. 1214 (2006); see also *Randolph* v. *Green Tree Fin. Corp.*, 244 F.3d 814, 818 (11th Cir. 2001) (same). The *Jenkins* Court explained that the denial of a class-action mechanism was not unconscionable because the availability of attorney's fees under the arbitration agreement provided plaintiffs with effective access to legal representation, and therefore "arbitration agreements prohibiting class action relief do not necessarily choke off the supply of lawyers willing to pursue claims on behalf of debtors." 400 F.3d at 878 (internal quotation marks omitted).

The Eleventh Circuit's ruling in *Jenkins*, in turn, relied on the Fourth Circuit's decision in *Snowden* v. *Checkpoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002). There, the Fourth Circuit enforced an arbitration agreement and rejected the consumer's claim that the agreement was unconscionable on the alleged ground that "without the class action vehicle,

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[5] The First Circuit has noted the close relationship between these methods of analysis because "the unconscionability analysis always includes an element that is the essence of the vindication of statutory rights analysis." *Kristian*, 446 F.3d at 60 n.22; *see Faber* v. *Menard, Inc.*, 367 F.3d 1048, 1053 (8th Cir. 2004) (applying "vindication of statutory rights" analysis to assess unconscionability argument); *Booker* v. *Robert Half Int'l, Inc.*, 413 F.3d 77, 84 (D.C. Cir. 2005) (applying "vindication of statutory rights" analysis to assess enforceability of arbitration agreement applied to state law claims).

[plaintiff] will be unable to maintain her legal representation given the small amount of her individual damages." *Id.* at 638. The Fourth Circuit explained that plaintiff's fears about the loss of her legal representation were unfounded because "'[a]ttorneys' fees'" were recoverable by a prevailing plaintiff in arbitration. *Id.* at 638-39. The court of appeals further rejected the argument that "forcing consumers . . . to arbitrate consumer protection claims [was] against public policy relating to consumer protection." *Id.* at 639.

The Fourth Circuit's decision in *Snowden* expressly followed the Third Circuit's decision in *Johnson* v. *West Suburban Bank*, 225 F.3d 366 (3d Cir. 2000). In *Johnson*, the court of appeals, through Judge Becker, explained that although individual arbitration of consumer claims under the Truth in Lending Act ("TILA") "that might have been pursued as part of class actions potentially reduces the number of plaintiffs seeking to enforce the TILA against creditors, arbitration does not eliminate plaintiff incentives to assert rights under the Act." *Id.* at 374. Accordingly, the FAA mandated enforcement of individual arbitration. *Id.* at 374-75. *See also Livingston* v. *Associates Fin., Inc.*, 339 F.3d 553, 559 (7th Cir. 2003) (following *Johnson* and *Randolph* and compelling arbitration of agreement that precludes "class action arbitration" of TILA claims).

c. Resolution of this conflict is of critical importance because the enforceability of agreements to arbitrate individually under the FAA is an issue that affects the rights set forth in consumer agreements entered into by individuals and businesses across the country.

As noted, private agreements to arbitrate are protected by federal law because they provide for a

lower-cost, streamlined means of resolving disputes that benefits both individual consumers and businesses. Indeed, "Congress, when enacting [the FAA], had the needs of consumers, as well as others, in mind." *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 280 (1995). Recognizing these benefits, arbitration agreements are contained in countless agreements between individual consumers and the businesses that compete to provide them internet service, cable service, banking and credit card services, computers and software, and wireless and wireline telephone service.

The decision below, however, adopts an interpretation of the FAA that undermines the enforceability of these ubiquitous agreements and threatens the mutual benefits that they provide to consumers and businesses. "Standard-form agreements are a fact of life," *Oblix, Inc.* v. *Winiecki*, 374 F.3d 488, 491 (7th Cir. 2004); they "reduce transaction costs and benefit consumers because, in competition, reductions in the cost of doing business show up as lower prices," *Carbajal* v. *H&R Block Tax Servs., Inc.*, 372 F.3d 903, 906 (7th Cir. 2004) (Easterbrook, J.). As the Seventh Circuit has explained, state law should not be permitted to trump federal law in this area because "[t]he cry of 'unconscionable!' just repackages the tired assertion that arbitration should be disparaged as second-class adjudication." *Id.* Indeed, legal commentators have explained that courts are applying new forms of "unconscionability" doctrine in an effort to strike down or rewrite agreements to arbitrate.[6]

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[6] *See* Michael G. McGuinness & Adam J. Karr, *California's "Unique" Approach to Arbitration: Why This Road Less Traveled Will Make All the Difference on the Issue of Preemption Under the Federal Arbitration Act*, 2005 J. Disp. Resol. 61, 62 (2005)

In this case, the district court and court of appeals applied *Shroyer* and *Discover Bank* to hold that individual arbitration of consumer disputes is "unconscionable" under California law and that the FAA's liberal policy in favor of enforcing arbitration agreements must give way to the requirements of state law. *Shroyer*, 498 F.3d at 988; *Discover Bank*, 113 P.3d at 1106. Likewise, the Washington Supreme Court and First Circuit both have followed *Discover Bank* and refused to enforce agreements to arbitrate that do not provide class procedures in claims involving consumers. See *Kristian*, 446 F.3d at 59-60; *Scott*, 161 P.3d at 1006.

In direct conflict, the Third Circuit in *Gay* has ruled that the enforceability of agreements to arbitrate is an issue of federal law and state unconscionability law cannot be used to avoid individual arbitration of consumer claims. *Gay*, 2007 WL 4410362, at *21. The Ninth Circuit, after expressly considering the Third Circuit's contrary analysis, "declined to follow the Third's Circuit's holding in *Gay*." *Lowden*, 2008 WL 170279, at *8 n.3.

Further, the suggestion that individual arbitration is "unconscionable" likewise cannot be reconciled with other decisions of the Third Circuit, as well as those

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("California has created a new brand of unconscionability. It is far more demanding—and it is unique to arbitration."); Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buff. L. Rev. 185, 186 (2004) ("increased receptivity to claims of unconscionability in the context of arbitration agreements suggests judicial hostility to arbitration"); Stephen J. Ware, *Arbitration and Unconscionability After Doctor's Associates, Inc. v. Casarotto*, 31 Wake Forest L. Rev. 1001, 1034 (1996) ("Judicial decisions apply unconscionability, and other common law doctrines, more aggressively to arbitration agreements than to other contracts.").

of the Fourth, Seventh, and Eleventh Circuits. Each of those federal circuits has held that that individual arbitration is enforceable under the FAA in cases involving small claims by consumers notwithstanding the absence of class-wide procedures of the sort required by *Shroyer* and *Discover Bank*. See, *e.g.*, *Johnson*, 225 F.3d at 373; *Jenkins*, 400 F.3d at 878; *Livingston*, 339 F.3d at 559; *Snowden*, 290 F.3d at 638-39.

Resolution of this conflict is of paramount importance because, as noted, the FAA governs the rights of tens millions of individuals and businesses across the country that have adopted agreements to arbitrate as an alternative to litigation in a broad range of transactions affecting interstate commerce. The enforceability of these agreements to arbitrate individually has been, and is being, challenged across the country based on *Discover Bank* and *Shroyer*, decisions which attempt to mask "judicial hostility" to individual arbitration under the cover of state-law "unconscionability."

The enforceability of these agreements should not be made to depend on which of the competing interpretations of the FAA has been adopted by a particular state or federal circuit. Accordingly, this Court should grant review in this case to ensure the uniform application of the FAA in an area of fundamental practical importance.

II. THE DECISION BELOW CONFLICTS WITH THIS COURT'S PRECEDENT.

Review also is warranted because the decision below conflicts with this Court's decisions on the fundamental relationship between the FAA and state-law substantive and procedural policies.

a. As this Court's decisions make plain, the FAA "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 25 (1983). Under the FAA, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Id.* at 24-25. That "liberal federal policy favoring arbitration" remains applicable "notwithstanding any state substantive or procedural policies to the contrary." *Id.* at 24.

To be sure, the FAA does not entirely displace state-law contract principles. Rather, Section 2 of the FAA provides that agreements to arbitrate "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Thus, any treatment of arbitration agreements that is different from all other contracts is expressly forbidden, for "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2." *Perry*, 482 U.S. at 493 n.9; see *Doctor's Assocs.*, 517 U.S. at 684, 687 (state law that required conspicuous disclosure of arbitration agreement preempted because it gave arbitration provisions a "suspect status"). Further, a court may not rely upon a state-law rule that applies to some, but not all, contracts as a basis for refusing to enforce an agreement to arbitrate. See *Southland Corp.* v. *Keating*, 465 U.S. 1, 16 n.11 (1984); *Perry*, 482 U.S. at 489-90.

b. Here, the Ninth Circuit's ruling, which adopts *Shroyer*, 498 F.3d at 984 – and with it *Discover Bank*,

113 P.3d at 1106 – conflicts with this Court's decisions. It conflicts with *Perry* because it is based upon the conclusion that an agreement to arbitrate is unconscionable because it does not provide class-wide procedures that might be available in litigation. That, however, is precisely what *Perry* explained was prohibited by the FAA: Reliance on the "uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." 482 U.S. at 493 n.9. It further conflicts with *Southland* because it adopts a standard applicable only to certain contracts, rather than a rule generally applicable to "any contract," as a basis for refusing to enforce the parties' agreement to arbitrate. See 465 U.S. at 16 & n.11.

In evaluating whether the FAA permits California law to refuse enforcement of the parties' agreement, the Ninth Circuit never addressed whether Laster could protect her rights under California law through individual arbitration. See, *e.g.*, *Shearson/Am. Express, Inc.* v. *McMahon*, 482 U.S. 220, 232 (1987) ("the streamlined procedures of arbitration do not entail any consequential restriction on substantive rights"). Indeed, the Ninth Circuit's decision in *Shroyer* makes plain that the availability of attorneys' fees and the payment of "the full cost of arbitration" by the defendant are, in that court's view, not relevant to a determination whether individual arbitration is unconscionable. 498 F.3d at 986. The court below followed *Shroyer*'s holding that an agreement to arbitrate individual claims was unconscionable based on the effect that it might have on the actions of third parties. *Id.* (asserting that few plaintiffs would pursue claims on an individual basis).

This Court, however, has explained that arbitration agreements must be enforced without regard to any effect on third parties. In *Moses H. Cone*, this Court explained that "an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." 460 U.S. at 20. Likewise, in *Dean Witter Reynolds, Inc.* v. *Byrd*, this Court held that principles of judicial efficiency must give way to the parties' agreement to arbitrate because "federal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement." 470 U.S. 213, 221 (1985) (internal quotes omitted).

Nor can the decision below be justified on the grounds, relied upon by *Shroyer* and *Discover Bank*, that California law mandates the availability of class-wide procedures for resolution of consumer claims both in litigation *and* arbitration. See *Shroyer*, 498 F.3d at 988 ("'[T]he principle that class action waivers are, under certain circumstances, unconscionable as unlawfully exculpatory is a principle of California law that does not specifically apply to arbitration agreements, but to contracts generally'") (quoting *Discover Bank*, 113 P.3d at 1112). To be sure, a state law that singles out arbitration for disfavored treatment directly violates the FAA. *Doctor's Assocs.*, 517 U.S. at 687. Under this Court's precedent, however, states cannot employ unconscionability principles to remake arbitration as the mirror image of litigation.

To the contrary, under the FAA, "parties are generally free to structure their arbitration agreements as they see fit," and to "specify by contract the rules under which that arbitration will be conducted." *Volt*, 489 U.S. at 479. The FAA favors

arbitration because it provides an alternative to litigation: a party "trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985). The FAA mandates enforcement of an agreement to arbitrate even where the procedures chosen by the parties are different from those in litigation.

Insistence by states that arbitration replicate litigation undermines the role of arbitration as an alternative means of dispute resolution. Indeed, in *Discover Bank*, the California Supreme Court candidly acknowledged that its requirement of class-wide procedures in arbitration involving consumers would create a "hybrid" form of dispute resolution that "'would entail a greater degree of judicial involvement than is normally associated with arbitration.'" 113 P.3d at 1106. Under the FAA, Congress' "clear intent" was "to move the parties to an arbitrable dispute *out of court and into arbitration* as quickly and easily as possible." *Moses H. Cone*, 460 U.S. at 22 (emphasis added). State law cannot be used to pull parties who have agreed to arbitrate back into court.

In short, review also is warranted because the decision below conflicts with this Court's decision explaining that the FAA does not permit state contract law to condition enforcement of agreements to arbitrate on the parties' adoption of the procedures already available in litigation. *E.g.*, *Perry*, 482 U.S. at 493 n. 9; *Southland*, 465 U.S. at 16 & n.11.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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January 23, 2007

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
NINTH CIRCUIT

[Filed Oct. 25, 2007]

No. 06-55010

JENNIFER L. LASTER; ANDREW THOMPSON; ELIZABETH VOORHIES, on behalf of themselves and all others similarly situated and on behalf of the general public,

Plaintiffs-Appellees,

v.

T-MOBILE USA, INC.; OMNIPOINT COMMUNICATIONS, INC., a Delaware corporation dba T-MOBILE,

Defendants-Appellants,

And

VERIZON COMMUNICATIONS, INC., a Delaware corporation; CELLCO PARTNERSHIP, a Delaware corporation dba VERIZON WIRELESS; VERIZON WIRELESS (VAW) LLC, a Delaware limited liability company, dba VERIZON WIRELESS; AIRTOUCH CELLULAR, a Delaware limited liability company, dba VERIZON WIRELESS; CINGULAR WIRELESS LLC, a Delaware limited liability company; GO WIRELESS, a California corporation; NEW CINGULAR WIRELESS PCS, dba CINGULAR WIRELESS,

Defendants.

Submitted Oct. 16, 2007*

Appeal from the United States District Court for the Southern District of California; Dana M. Sabraw, *District Judge*, Presiding. D.C. No. CV-05-01167-DMS.

Before: PREGERSON, HAWKINS, and FISHER, *Circuit Judges*.

MEMORANDUM**

T-Mobile USA, Inc., Omnipoint Communications, Inc., and TMO CA/NV, LLC (collectively, "Appellants") appeal from the district court's order denying their motion to compel arbitration. We affirm.

Although Appellants argue that their arbitration provision is not procedurally or substantively unconscionable under California law, the Appellants' agreement—which requires customers to waive class action and bring claims only in an individual capacity—is not substantively distinguishable from the Cingular arbitration agreement this court held unconscionable in *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976, 2007 WL 2332068, at *5-9 (9th Cir. 2007).

Appellants argue their agreement is not procedurally unconscionable because customers accepted the arrangement from the outset and could have elected a different mobile phone company; however,

* The panel unanimously finds this case suitable for decision without oral argument. *See* Fed. R. App. P. 34(a)(2).

** This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

this court specifically rejected the "marketplace alternatives" rationale in *Shroyer*, *id.* at *7-8, and California courts have done the same, *Gatton v. T-Mobile USA, Inc.*, 152 Cal. App. 4th 571, 582-85 (2007).

Shroyer also expressly and conclusively rejected the argument that California law is preempted by the Federal Arbitration Act ("FAA"), 498 F.3d 976, 2007 WL 2332068, at *9-15, and we lack the authority to revisit the decision of a prior three-judge panel. *Miller v. Gammie*, 335 F.3d 889, 899-900 (9th Cir. 2003) (en banc). Appellants' attempts to circumvent this rule are unavailing, as this is not a case where the prior panel simply assumed California law applied without discussing the preemptive effect of the FAA. *Cf. Sakamoto v. Duty Free Shoppers, Ltd.*, 764 F.2d 1285, 1288 (9th Cir. 1985) (prior panel assumed Commerce Clause applied to Guam without discussing the issue); *Matter of Baker*, 693 F.2d 925, 925-26 (9th Cir. 1982) (prior panel exercised jurisdiction and parties did not contest the issue). Even if *Shroyer* did not address the specific arguments Appellants would like to make, there is no doubt that it clearly and explicitly ruled on the contested preemption issue.

AFFIRMED.

APPENDIX B

UNITED STATES DISTRICT COURT
S.D. CALIFORNIA

No. 05 CV 1167 DMS(AJB)

JENNIFER L. LASTER; et al.,
Plaintiffs,

v.

T-MOBILE USA, INC., et al.,
Defendants.

Nov. 30, 2005

ORDER: (1) DENYING T-MOBILE AND CINGULAR WIRELESS' MOTION TO COMPEL ARBITRATION AND TO STAY PROCEEDINGS; (2) GRANTING DEFENDANTS' MOTION TO DISMISS PLAINTIFFS' UCL AND FAL CLAIMS WITHOUT PREJUDICE; AND (3) GRANTING DEFENDANTS' MOTION TO DISMISS PLAINTIFFS' CLRA CLAIM FOR DAMAGES WITH PREJUDICE

[Docs. Nos. 24, 28, 32, 36]

SABRAW, *District Judge*.

In this putative class action, Plaintiffs assert that Defendants—cellular phone companies and other entities involved with the sale of wireless telecommunication services—have engaged in the unfair and deceptive practice of charging consumers sales tax on the full retail value of cellular phones that were advertised as "free" or at substantial discounts, in violation of California's Unfair Competition Law

("UCL"), Cal. Bus. & Prof.Code § 17200, *et. seq.*, and False Advertising Law ("FAL"), Cal. Bus. & Prof. Code § 17500, *et. seq.* In addition, based on these alleged violations, Plaintiffs seek damages and injunctive relief under the Consumer Legal Remedies Act ("CLRA"), Cal. Civ.Code § 1770, *et. seq.*

Presently before the Court are two motions. First, Defendants T-Mobile USA, Inc. ("T-Mobile") and Cingular Wireless ("Cingular") have filed separate motions to compel Plaintiffs Jennifer L. Laster ("Laster") and Elizabeth Voorhies ("Voorhies") to arbitration, based on the arbitration clauses contained in their wireless service contracts. In addition, Defendants Verizon Wireless and Go Wireless, Inc. have filed a joint motion under Fed.R.Civ.P. 12(b)(6) to dismiss Plaintiffs' First Amended Class Action Complaint ("FAC") for failure to state a claim. Defendants T-Mobile and Cingular have joined that motion. On October 28, 2005, the Court heard oral argument on both motions. For the reasons discussed below, the Court denies T-Mobile and Cingular's motions to compel arbitration, and grants Defendants' collective motion to dismiss Plaintiffs' UCL and FAL claims without prejudice. Further, the Court grants Defendants' motion to dismiss Plaintiffs' CLRA damages claim with prejudice.

I.

FACTUAL AND PROCEDURAL BACKGROUND

Defendants are engaged in the business of marketing and selling wireless telecommunications products, including cellular phones, accessories and service. These products are often sold as part of a "bundled" transaction, whereby the consumer receives a free or significantly discounted cellular phone, in exchange for agreeing to a wireless service

contract for a specified duration; however, when Defendants offer the free or substantially discounted phone as part of a bundled transaction, they generally charge consumers sales tax (approximately 7.75%) based on the full retail value of the phone. Plaintiffs contend this practice is improper because a phone advertised as "free" should not include sales tax, and a phone advertised at a substantial discount should include only the sales tax based on the phone's discounted price, rather than its full retail value.

On November 14, 2004, Voorhies entered into bundled transaction to obtain a new cellular phone and wireless service from Cingular, through its authorized agent, Go Wireless, in Poway, California. (Plaintiffs' FAC at ¶ 5.) In conjunction with the purchase of the service package, Voorhies was not charged any amount for the phone. (*Id.*) However, Defendants charged Voorhies a total of $10.31 in sales tax, based on the retail value of the phone. (*Id.*) At the time Voorhies entered into the transaction, she was provided with a copy of Cingular's one page "Wireless Service Agreement," which provides in its "Contract Provisions" section:

> This Agreement includes all the provisions of Cingular's current [T]erms of [S]ervice form FMS TC P 1104 0055 E, incorporated herein by reference, *including a binding arbitration clause.* It also includes and incorporates additional provisions contained in a separate rate plan or other brochure(s) describing the services to which I subscribed ("Rate Plan Brochure"). I agree to all these contract provisions.

(*See* Green Decl. at ¶¶ 6 & 7; Service Agreement, attached thereto) (emphasis added).

The Service Agreement further provides:

> I HAVE READ, UNDERSTAND, AND AGREE TO BE BOUND BY THIS AGREEMENT WITH ITS TERMS OF SERVICE AND RATE PLAN BROCHURE (including Changes to Terms and Rates, Limitation of Liability and *Arbitration*).

(*See id.*) (emphasis added).

Voorhies also received at that time a copy of Cingular's "Terms of Service," which is a thirteen page document detailing the terms and conditions of Cingular's service. (Green Decl. at ¶ 10.) The Terms of Service, at page 10, includes a section entitled "Arbitration," which purports to waive the consumer's rights to (a) file claims in a court of law against Cingular, and (b) participate in a class action lawsuit against Cingular. Specifically, Cingular's arbitration clause provides:

> CINGULAR and you . . . agree to arbitrate all disputes and claims (including ones that already are the subject of litigation) arising out of or relating to this Agreement, or to any prior oral or written agreement, for Equipment or services between CINGULAR and you . . . . A party who intends to seek arbitration must first send to the other, by certified mail, a written Notice of Intent to Arbitrate ("Notice") . . . . If we do not reach agreement to resolve the claim within 30 days after the Notice is received, you or Cingular may commence an arbitration proceeding. After Cingular receives notice at the Arbitration Notice Address that you have commenced arbitration, it will promptly reimburse you for your payment of the filing fee. . . . Cingular will pay all [American Arbitration Association] filing, administration

> and arbitrator fees for any arbitration initiated in accordance with the notice requirements above . . . . If the arbitrator grants relief to you that is equal to or greater than the value of your Demand, Cingular shall reimburse you for your reasonable attorneys' fees and expenses incurred in the arbitration . . . . You agree that, by entering into this Agreement, you and Cingular are waiving the right to trial by jury . . . . You and Cingular agree that YOU AND CINGULAR MAY BRING CLAIMS AGAINST THE OTHER ONLY IN YOUR OR ITS INDIVIDUAL CAPACITY, and not as a plaintiff or class member in any purported class or representative proceeding.

(Cingular's Terms of Service at 10-12, attached to Green Decl.) (emphasis in original).

After Voorhies received copies of the Wireless Service Agreement and Terms of Service, she was—pursuant to Cingular's procedures for activation of cellular service—directed to call a number provided by Cingular for electronic activation of phone service. (Green Decl. at ¶ 11.) Voorhies was then prompted to execute an electronic signature by selecting the "Yes" option using her telephone keypad in response to the statement: "You agree to the terms as stated in the Wireless Service Agreement and Terms of Service." (*Id.* at ¶ 12.) If Voorhies did not respond "Yes" to this question, the system would automatically decline her service contract, and her phone would not be activated. (*Id.*) Voorhies agreed to the terms, and her phone was activated. (*Id.* at ¶ 13.)

On February 23, 2005, Laster entered into a bundled transaction with T-Mobile at its Mission Valley Center Store in San Diego, California,

whereby she purchased a new phone and activated cellular service. (Plaintiffs' FAC at ¶ 3; Chang Decl. at ¶ 2.) When Laster entered into the transaction, she signed a one page Service Agreement which identified her plan rate and the equipment she purchased. (Chang Decl. at ¶ 2.) The Service Agreement neither mentioned arbitration nor incorporated by reference such a provision. After Laster signed the agreement, she received a one page transaction receipt which indicated, among other things, that while T-Mobile did not charge any amount for the phone, it was charging $28.22 for sales tax based on the full retail value of the phone. (*Id.*)

In addition to receiving a new phone, Laster was provided with a copy of T-Mobile's fifty-two page "Welcome Guide", which was placed inside the sealed box accompanying her new phone. (*Id.* at 3.) The Welcome Guide includes information about the phone's features and service, as well as the "Terms and Conditions" of its Service Agreement. Similar to Cingular, T-Mobile's Terms and Conditions includes an arbitration clause and waiver of class action participation. T-Mobile's arbitration clause provides:

> Mandatory Arbitration; Dispute Resolution. YOU WILL FIRST NEGOTIATE WITH U.S. IN GOOD FAITH TO SETTLE ANY CLAIM OR DISPUTE BETWEEN YOU AND U.S. IN ANY WAY RELATED TO OR CONCERNING THE AGREEMENT, OR OUR PROVISION TO YOU OF GOODS, SERVICES OR UNITS ("CLAIM"). . . . . IF YOU DO NOT REACH AGREEMENT WITH U.S. WITHIN 30 DAYS, INSTEAD OF SUING IN COURT, YOU AGREE THAT ANY CLAIM MUST BE SUBMITTED TO FINAL, BINDING ARBITRATION WITH THE

> AMERICAN ARBITRATION ASSOCIATION ("AAA") . . . . You will pay your share of the arbitrator's fees except: (a) for claims less than $25, we will pay all arbitrator's fees and (b) for claims between $25 and $1000, you will pay $25 for the arbitrator's fee. You and we agree to pay our own other fees, costs and expenses including those for counsel, experts, and witnesses. YOU AND WE ACKNOWLEDGE AND AGREE THAT THIS SEC[TION] . . . WAIVES ANY RIGHT TO A JURY TRIAL, OR PARTICIPATION AS A PLAINTIFF OR A CLASS MEMBER IN A CLASS ACTION.

(T-Mobile's Welcome Guide, § 4 (Terms and Conditions) at ¶¶ 3 & 4, attached as Exhibit D to Chang Decl.) (emphasis in original). Laster alleges that before receiving T-Mobile's Welcome Guide, she was unaware of T-Mobile's arbitration clause. (Plaintiffs' Opposition to T-Mobile's Motion to Compel at 7.)

In May of 2005, Laster, Voorhies, and an additional named Plaintiff in this lawsuit, Andrew Thompson, each filed suits in the Superior Court of San Diego County. Subsequently, two of the cases were removed to this Court pursuant to the Class Action Fairness Act of 2005 ("CAFA"), 28 U.S.C. §§ 1711, *et. seq*. The third action against Defendants was dismissed without prejudice.

On August 12, 2005, Plaintiffs filed their FAC with this Court against Defendants. Plaintiffs allege for themselves and on behalf of all consumers who purchased a cellular phone as part of a bundled transaction, that Defendants' practice of advertising "free" or significantly discounted phones, while charging sales tax on the full retail value of the phones, constitutes misleading and unlawful business acts and practices

under California's FAL, UCL and CLRA. Defendants challenge the FAC through their motions to compel arbitration and to dismiss. These motions are addressed below.

II.

DISCUSSION

A. Motion to Compel Arbitration

1. Legal Standard

The Federal Arbitration Act ("FAA") governs arbitration agreements in contracts involving transactions in interstate commerce. 9 U.S.C. § 1; *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 n. 32, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). Congress intended courts to construe commerce as broadly as possible. *Simula, Inc. v. Autoliv, Inc.*, 175 F.3d 716, 719 (9th Cir.1999). Pursuant to Section 2 of the FAA, arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds that exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. In determining whether to compel a party to arbitration, a district court may not review the merits of the dispute; rather, the court must limit its inquiry to: (1) whether a valid agreement to arbitrate exists, and, if it does (2) whether the agreement encompasses the dispute at issue. *Chiron Corp. v. Ortho Diagnostic Sys., Inc.*, 207 F.3d 1126, 1130 (9th Cir.2000). Finally, a court interpreting an arbitration agreement must give due regard to the federal policy favoring arbitration; ambiguities as to the scope of the arbitration clause are resolved in favor of arbitration. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62, 115 S.Ct. 1212, 131 L.Ed.2d 76 (1995); *AT & T Techs. Inc. v. Comm. Workers of America*, 475 U.S. 643, 650, 106

S.Ct. 1415, 89 L.Ed.2d 648 (1986) ("in the absence of any express provision excluding a particular grievance from arbitration . . . only the most forceful evidence of a purpose to exclude the claim from arbitration can prevail.")

T-Mobile and Cingular contend Laster and Voorhies are bound by the terms of the arbitration agreements contained in their wireless service agreements, and therefore, this Court is not the proper forum to adjudicate their claims. Laster and Voorhies respond by arguing that the arbitration clauses are not enforceable against them because the subject provisions are unconscionable.

2. Unconscionability

While federal policy favors arbitration agreements, federal courts rely on state law when addressing issues of contract validity and enforceability. *Ticknor v. Choice Hotels Int'l, Inc.*, 265 F.3d 931, 936-37 (9th Cir.2001). Thus, generally applicable contract defenses such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening Section 2 of the FAA. *Ticknor*, 265 F.3d at 937 (citing *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 686, 116 S.Ct. 1652, 134 L.Ed.2d 902 (1996)). On a motion to compel arbitration, the trial court does not determine whether the contract as a whole is unconscionable. Instead, the court is limited to determining whether the arbitration clause itself is unconscionable. *See Gray v. Conseco, Inc.*, 2000 WL 1480273 (C.D.Cal.2000).

The unconscionability analysis begins with an inquiry into whether the contract is one of adhesion. *See Armendariz v. Foundation Health Psychcare Services*, 24 Cal.4th 83, 113, 99 Cal.Rptr.2d 745, 6

P.3d 669 (Cal.2000). An adhesion contract is a "standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." *Id.* at 113, 99 Cal.Rptr.2d 745, 6 P.3d 669 (citation omitted). An adhesion contract is unconscionable when *both* procedural and substantive unconscionability are present. *Id.* at 114, 99 Cal.Rptr.2d 745, 6 P.3d 669. Procedural and substantive unconscionability, however, "need not be present in the same degree." *Id.* When great substantive unconscionability is present, less procedural unconscionability is required before the agreement will be invalidated. *Id.* Finally, a party challenging an arbitration agreement has the burden to prove both procedural and substantive unconscionability. *Crippen v. Central Valley RV Outlet, Inc.*, 124 Cal.App.4th 1159, 1165, 22 Cal.Rptr.3d 189 (2004).

a. Procedural Unconscionability

Procedural unconscionability concerns the manner in which the contract was negotiated and the circumstances of the parties at that time. *A & M Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473, 491, 186 Cal.Rptr. 114 (1982). The procedural element of unconscionability focuses on two factors: oppression and surprise. *Id.* at 486, 186 Cal.Rptr. 114. The oppression component arises from an inequality of bargaining power of the parties to the contract and an absence of real negotiation or a meaningful choice on the part of the weaker party. *California Grocers Assn. v. Bank of America*, 22 Cal.App.4th 205, 214, 27 Cal.Rptr.2d 396 (1994). "Surprise involves the extent to which the terms of the bargain are hidden in a 'prolix printed form' drafted by a party in a superior

bargaining position." *Crippen*, 124 Cal.App.4th at 1165, 22 Cal.Rptr.3d 189 (citation omitted).

T-Mobile and Cingular do not dispute that the arbitration agreements between the parties were part of a non-negotiable form contract. Further, they do not challenge Plaintiffs' argument that a disparity in bargaining power exists between the parties. However, T-Mobile and Cingular argue that Laster and Voorhies cannot establish that the agreements are procedurally unconscionable due to "oppression" because they were not compelled to accept the terms contained in the service contracts; Laster and Voorhies were "able to choose from a host of wireless carriers offering services in a given market"—including carriers that do not insist on arbitration of disputes. (T-Mobile's Motion to Compel at 10-11; Cingular's Motion to Compel at 7.) Defendants cite *Morris v. Redwood Empire Bancorp*, 128 Cal.App.4th 1305, 1319-20, 27 Cal.Rptr.3d 797 (2005), for the proposition that "the 'oppression' factor of the procedural element of unconscionability may be defeated, if the complaining party has a meaningful choice of reasonably available sources of supply from which to obtain the desired goods and services free of the terms claimed to be unconscionable." (Cingular's Motion to Compel at 6.) The problem with this argument, however, is that the Ninth Circuit has rejected it.

In *Ting v. AT&T*, 319 F.3d 1126, 1149 (9th Cir.2003), the Ninth Circuit addressed this very argument. There, AT & T mailed a Consumer Services Agreement (CSA) to its customers along with the customer's monthly bill and other materials. The CSA purported to mandate arbitration of claims and bar customers from pursuing claims against AT

& T on a classwide basis. AT & T argued its arbitration provision in the CSA was not procedurally unconscionable because "the third largest carrier, Verizon, had no arbitration agreement in [its] contract and . . . consumers therefore had the option of rejecting AT & T's CSA and switching to a competitor." *Id.* at 1149.

The court in *Ting* dismissed the argument, first noting: "A contract *is* procedurally unconscionable if it is a contract of adhesion, *i.e.*, a standardized contract, drafted by the party of superior bargaining strength, that relegates to the subscribing party only the opportunity to adhere to the contract or reject it." *Ting*, 319 F.3d at 1148-49 (emphasis added) (citing *Flores v. Transamerica HomeFirst, Inc.*, 93 Cal.App.4th 846, 853, 113 Cal.Rptr.2d 376 (2001) ("'A finding of a contract of adhesion is essentially a finding of procedural unconscionability.'")) In addition, the court in *Ting* held: "[E]ven assuming such alternatives matter under California law, *see Armendariz*, . . . (rejecting contention that availability of alternative sources of supply affected the procedural unconscionability analysis), it nonetheless fails to overcome the district's court's well-founded conclusion that the CSA is a procedurally unconscionable contract [because AT & T imposed the CSA on its customers without opportunity for negotiation, modification, or waiver]." *Id.* Accordingly, *Ting* holds: (1) a contract of adhesion is procedurally unconscionable, and (2) even if a court were to consider the availability of alternative sources of supply, the court must evaluate the consumer's opportunity to negotiate the arbitration provision.

Here, it is undisputed Laster and Voorhies were presented with *non-negotiable* form contracts. They

could either accept the contract with arbitration, or reject it. Under *Ting*, such "take it, or leave it" contracts are deemed to be procedurally unconscionable contracts of adhesion. The only question for this Court, therefore, is where on the continuum of procedural unconscionability do the subject agreements fall?[1]

With respect to T-Mobile, the one page Service Agreement Laster signed does *not* include any reference to arbitration or waiver of class action participation. Rather, Laster was theoretically notified of the arbitration clause through T-Mobile's fifty-two page "Welcome Guide", which was placed inside the sealed box containing her new phone. Laster claims she neither signed nor acknowledged the arbitration provision, because she never knew it existed. (Opposition to Motion to Compel at 7.) Nevertheless, T-Mobile contends Laster accepted the terms of arbitration by activating her phone because she "had time to review and understand" the Welcome Guide and its arbitration provision, and "she was allowed to return her phone and cancel her T-Mobile service within 14 days, with no penalty." (T-Mobile's Motion to Compel at 4.)

Under these circumstances, Laster had no meaningful opportunity to negotiate the terms of the

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[1] Defendants cite *Crippen*, 124 Cal.App.4th at 1165, 22 Cal.Rptr.3d 189, for the proposition that "there is no general rule that a form contract used by party for many transactions is procedurally unconscionable. Rather, '[p]rocedural unconscionability focuses on the manner in which the disputed clause is presented to the party in the weaker bargaining position.'" (citation omitted). This holding, however, is contrary to the holding in *Ting*. Nonetheless, *Crippen's* holding remains relevant to the determination of the *level* of procedural unconscionability.

service contract before purchasing the phone. In other words, she had no opportunity to switch to another competitor until *after* she purchased the phone. On this record, it appears Laster's ability to "negotiate" depended upon her ability to discover the arbitration provision on her own and then cancel her service within 14 days of purchasing and activating her phone. The manner in which the T-Mobile's arbitration provision was presented to Laster clearly suggests procedural unconscionability at a heightened level.

Cingular's arbitration clause, on the other hand, presents a closer call. In contrast to Laster, Voorhies was provided with both Cingular's Service Agreement (which specifically references arbitration) and its Terms of Service *at the time* she purchased the phone. As Cingular notes, "At that time, Voorhies had neither invested in a telephone nor become reliant upon the telephone number obtained when she entered into her agreement." (Cingular's Motion to Compel at 8.) In other words, Voorhies could, at that point, elect to "leave it" and go with a competitor, such as Verizon.

However, under *Ting*, Cingular nonetheless presented Voorhies with a take-it-or-leave-it form contract that is deemed to be adhesive and thereby, procedurally unconscionable. Similar to Laster, Voorhies had no real opportunity to "negotiate" the arbitration provision, as it was non-negotiable. She was, however, able to negotiate the transaction in the sense that she could at an early stage reject Cingular's terms and choose a competitor. As Cingular concedes, "At most, [under these circumstances] adhesiveness . . . puts Cingular's contracts on the low end of the spectrum of procedural unconscionability."

(Cingular's Motion to Compel at 7.) This Court would agree.

T-Mobile and Cingular next argue that Laster and Voorhies fail to show the "surprise" element of procedural unconscionability. In support, Defendants argue the terms of the arbitration agreements are adequately disclosed in their service contracts. (T-Mobile's Motion to Compel at 11; Cingular's Motion to Compel at 8.)

As noted, Laster was not made aware of the terms of the arbitration clause until after she had purchased the phone. The surprise element is therefore clearly established by Laster against T-Mobile.

Cingular argues, however, the "surprise" element is lacking because it "gave its arbitration provisions special prominence in its [Service] Agreement." (Cingular's Motion to Compel at 8.) While it is true Cingular's Service Agreement provides *notice* of arbitration, the agreement fails to mention the terms of arbitration or its classwide arbitration bar. In addition, the actual arbitration clause and class action waiver can only be determined by the customer by reading a separate document—specifically, pages ten through twelve of Cingular's thirteen page Terms of Service booklet. A modicum of surprise therefore exists under these circumstances.

In sum, for the reasons stated, T-Mobile and Cingular's arbitration provisions are procedurally unconscionable. To avoid enforcement, however, Laster and Voorhies also must establish substantive unconscionability.

b. Substantive Unconscionability

Plaintiffs argue T-Mobile and Cingular's arbitration clauses are substantively unconscionable because they include a waiver of class action rights, citing the recent California Supreme Court decision in *Discover Bank v. Superior Court of Los Angeles*, 30 Cal.4th 148 (Cal.2005). Defendants counter that: (1) *Discover Bank* does not hold that all such arbitration provisions are unconscionable; (2) under *Discover Bank's* test for substantive unconscionability, Plaintiffs fail to show the arbitration provisions in dispute are unconscionable; and (3) even if this Court were to conclude that *Discover Bank* invalidates class action waivers in all consumer arbitration provisions, that holding would be preempted by Section 2 of the FAA.

In *Discover Bank*, defendant, a credit card company, sent an arbitration agreement (as an amendment to its existing customer service agreement) in a "bill stuffer" along with its customers' monthly invoices. The arbitration agreement included a waiver of classwide arbitration. Plaintiffs later initiated a class action lawsuit, and Discover Bank moved to compel arbitration. The California Supreme Court held that a waiver of classwide arbitration in a consumer contract of adhesion may be unconscionable under certain circumstances. Specifically, the court concluded:

> We do not hold that all class action waivers are necessarily unconscionable. But when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large

> numbers of consumers out of individually small sums of money, then, at least to the extent the obligation at issue is governed by California law, the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.' (Civ.Code, § 1668.) Under these circumstances, such waivers are unconscionable under California law and should not be enforced.

Discover Bank, 30 Cal.4th at 162-63.

Accordingly, under *Discover Bank*, arbitration provisions that contain class action waivers are not *per se* unconscionable. Instead, a classwide arbitration bar is unconscionable only if two factors are present: (1) the class action waiver is contained in a consumer contract of adhesion, in which small amounts of damages are at issue; and (2) it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money.

Applying *Discover Bank's* two-prong test to the present facts leads to the conclusion that the arbitration provisions are substantively unconscionable. As noted, the arbitration clauses are contracts of adhesion because they are non-negotiable, presenting the consumer with only a take-it-or-leave-it option. Further, the dispute between the parties here involves individually small amounts of money—that is, the sales tax (approximately 7.75%) charged to the consumer, based on the retail value of a cellular phone. Thus, the first prong of *Discover Bank's* unconscionability test is satisfied.

T-Mobile argues Plaintiffs do not prevail under the second prong of *Discover Bank* because they fail to show T-Mobile deliberately cheated large numbers of consumers out of individually small sums of money. (T-Mobile's Motion to Compel at 16.) *Discover Bank*, however, does not require a plaintiff to show that a defendant *actually* carried out a scheme to cheat consumers out of money. Instead, *Discover Bank* holds that, "when it is *alleged* that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then . . . the waiver becomes in practice the exemption of the party from responsibility for [its] own fraud, or willful injury to the person or property of another." *Discover Bank*, 30 Cal.4th at 162-63. (emphasis added). In essence, for a classwide litigation bar to be considered substantively unconscionable, a plaintiff need only *allege* that a defendant engaged in a scheme to cheat consumers out of small sums of money. Here, Plaintiffs' allege Defendants' practice of advertising "free" or substantially discounted phones, while charging consumers sales tax on the full retail value of the phone, constitutes a scheme to mislead consumers. Accordingly, their allegations are sufficient to satisfy the second prong of *Discover Bank's* substantive unconscionability test.

Cingular raises the additional argument that because its arbitration provision provides for the full payment of arbitration costs, as well as reasonable attorney's fees to potential plaintiffs, "'the class-action waiver in its arbitration provision does not serve to insulate [it] from liability that otherwise would be imposed under California law'. . . and hence is not substantively unconscionable under *Discover Bank*." (Cingular's Motion to Compel at 9-10,13.)

Thus, Cingular essentially argues its arbitration provision allows potential plaintiffs to pursue claims against them under a system where the parties are on equal footing; because Cingular would pay a prevailing plaintiff's attorney's fees, it would have no incentive to defend itself in arbitration against a meritorious claim. (*Id.* at 12.)

The court in *Discover Bank* considered this argument, and rejected it, holding: "Nor are we persuaded by the rationale stated by some courts that the potential availability of attorney fees to the prevailing party in arbitration or litigation ameliorates the problem posed by such class action waivers . . . . There is no indication . . . attorney fees are an adequate substitute for the class action or arbitration mechanism."[2] *Discover Bank*, 30 Cal.4th at 162.

Because T-Mobile and Cingular's service contracts are non-negotiable form contracts, involving an

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[2] The court in *Ting*, 319 F.3d 1126, which presaged *Discover Bank*, also was concerned with classwide bars because such bars potentially could convert arbitration into a one-sided forum favoring the stronger party. "'Although parties are free to contract for asymmetrical remedies and arbitration clauses of varying scope . . . the doctrine of unconscionability limits the extent to which a stronger party may, through a contract of adhesion, impose the arbitration forum on the weaker party *without accepting that forum for itself.*'" *Id.* at 1149 (citing *Armendariz*, 24 Cal.4th 83, 99 Cal.Rptr.2d 745, 6 P.3d 669) (emphasis added). Because credit card companies typically do not sue their customers in class-action lawsuits, the *Ting* court concluded the classwide bar provision was manifestly one-sided and thus, substantively unconscionable. *Id.* at 1150. The *Ting* court's warning that such provisions may not be sufficiently bilateral, permeates *Discover Bank's* reasoning in its rejection of the classwide bar provision it was analyzing.

alleged scheme to cheat large numbers of consumers out of small sums of money, the arbitration clauses are substantively unconscionable. Further, because Laster and Voorhies have established the arbitration provisions are both procedurally and substantively unconscionable to a sufficient degree, the Court concludes the provisions are not enforceable against them.[3]

3. Preemption

T-Mobile and Cingular argue, in the alternative, that should the Court find the arbitration clauses substantively unconscionable, this Court still must compel Laster and Voorhies to arbitration because the holding in *Discover Bank* is preempted by the FAA. Section 2 of the FAA provides that "[a]n agreement shall be valid, irrevocable, and enforceable, save upon such grounds that exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2. (emphasis added). Likewise, in *Perry v. Thomas*, 482 U.S. 483, 492-93 n. 9, 107 S.Ct. 2520, 96 L.Ed.2d 426 (1987), the United States Supreme Court held that "an agreement to arbitrate is valid, irrevocable, and enforceable, as a matter of federal law, save upon such grounds as exist at law or in equity for the revocation of *any* contract." (emphasis added.) T-Mobile and Cingular argue that "because the test set forth in *Discover Bank* is not a rule of general applicability given that it only applies to a limited subset of arbitration agreements and disputes"—the unconscionability test articulated in *Discover Bank* is

[3] In light of the holding that Defendants' arbitration clauses are not enforceable, the Court declines to address the arguments regarding the scope of the arbitration clauses.

preempted by § 2 of the FAA. (T-Mobile's Motion to Compel at 17; Cingular's Motion to Compel at 13.)

In *Discover Bank*, the court noted a determination that a classwide bar is unconscionable is not preempted by § 2 of the FAA, because such a determination involves principles of state law regarding the "validity, revocability, and enforceability of contracts generally[.]" *Discover Bank*, 30 Cal.4th at 165. "'Under section 2 of the FAA, a state court may refuse to enforce an arbitration agreement based on generally applicable contract defenses, such as fraud, duress, or unconscionability.'" *Id.* (citations omitted.) *See also Ting*, 319 F.3d at 1150, n. 15 ("Because unconscionability is a generally applicable contract defense, it may be applied to invalidate an arbitration agreement without contravening § 2 of the FAA."). The concept of unconscionability, therefore, may be employed as a principle of general applicability to invalidate an arbitration agreement without contravening § 2 of the FAA. Accordingly, the holding of *Discover Bank* is not preempted by § 2 of the FAA.

B. Motion to Dismiss

1. Legal Standard

Under Federal Rule of Civil Procedure 12(b)(6), a district court must dismiss a complaint if it fails to state a claim upon which relief can be granted. The question presented by a motion to dismiss is not whether the plaintiff will prevail in the action, but whether the plaintiff is entitled to offer evidence in support of the claim. Fed.R.Civ.P. 12(b)(6). *See Scheuer v. Rhodes*, 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974), *overruled on other grounds by Davis v. Scherer*, 468 U.S. 183, 104 S.Ct. 3012, 82

L.Ed.2d 139 (1984). In answering this question, the Court must assume that the plaintiff's allegations are true and must draw all reasonable inferences in plaintiff's favor. *See Usher v. City of Los Angeles*, 828 F.2d 556, 561 (9th Cir.1987). Even if the face of the pleadings suggests that the chance of recovery is remote, the Court must allow the plaintiff to develop the case at this stage of the proceedings. *See United States v. City of Redwood City*, 640 F.2d 963, 966 (9th Cir.1981). If the Court dismisses the complaint, it must then decide whether to grant leave to amend. The Ninth Circuit has "repeatedly held that a district court should grant leave to amend even if no request to amend the pleading was made, unless it determines that the pleading could not possibly be cured by the allegation of other facts." *Lopez v. Smith*, 203 F.3d 1122, 1130 (9th Cir.2000) (citations and internal quotation marks omitted).

Defendants seek dismissal of Plaintiffs' FAC on four grounds: (1) Plaintiffs lack standing to bring their claims under California's UCL and FAL because they fail to adequately plead actual reliance and injury in fact; (2) Plaintiffs cannot allege false or deceptive advertising as a matter of law because consumers are expected to know that California law requires sales tax to be added to advertised items; (3) Plaintiffs' claim for restitution under the UCL and FAL fails because Defendants remitted the taxes collected from consumers to the State Board of Equalization; and (4) Plaintiffs' claim for damages under the CLRA should be dismissed because they fail to allege proper notice of their claim as required by California Civil Code § 1782. These arguments are addressed below.

2. Plaintiffs' UCL and FAL Claims

Section 17200 of the California Business and Professions Code defines "unfair competition" as "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising and any act prohibited by [the FAL]." Cal. Bus. & Prof. § 17200. By defining unfair competition to include any "unlawful . . . business act or practice", the UCL permits violations of other laws to be treated as unfair competition that are independently actionable. *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.*, 20 Cal.4th 163, 180, 83 Cal.Rptr.2d 548, 973 P.2d 527 (Cal.1999). As such, any violation of the FAL necessarily violates the UCL. *Committee on Children's Television, Inc. v. General Foods Corp.*, 35 Cal.3d 197, 210, 197 Cal.Rptr. 783, 673 P.2d 660 (Cal.1983).

The FAL, which is codified at Section 17500, provides: "[i]t is unlawful for any person . . . corporation or association, or any employee thereof . . . to disseminate or cause to be so made or disseminated [,] any such statement as part of a plan or scheme with the intent not to sell that personal property or those services, professional or otherwise, so advertised at the price stated therein, or as so advertised." Cal. Bus. & Prof. § 17500. California courts have noted that the FAL prohibits "not only advertising which is false, but also advertising which [,] although true, is either actually misleading or which has a capacity, likelihood or tendency to deceive or confuse the public." *Leoni v. State Bar*, 39 Cal.3d 609, 626, 217 Cal.Rptr. 423, 704 P.2d 183 (Cal.1985).

Proposition 64, which was approved by California voters on November 2, 2004, amended certain provi-

sions of the UCL and FAL. Before Proposition 64 passed, an uninjured private party could bring a UCL (or FAL) action on behalf of the "general public," and could obtain remedies on behalf of non-parties.

Proposition 64, however, amended Section 17204 of the UCL regarding private plaintiffs to read: "Actions for any relief pursuant to this chapter shall be prosecuted exclusively . . . by any person who has suffered injury in fact and has lost money or property as a result of such unfair competition." Cal. Bus. & Prof.Code § 17204. Section 17203, which was also amended by Proposition 64, now provides, with respect to representative private plaintiffs: "Any person may pursue representative claims or relief on behalf of others only if the claimant meets the standing requirements of Section 17204 and complies with Section 382 of the Code of Civil Procedure. . . ." Cal. Bus. & Prof.Code § 17203.

Accordingly, after Proposition 64, a person seeking to represent claims on behalf of others must show that (1) she has suffered actual injury in fact, and (2) such injury occurred as a result of the defendant's alleged unfair competition or false advertising. For the reasons set forth below, Plaintiffs adequately allege injury in fact, but fail adequately to allege causation.

With respect to the first prong—injury in fact—Plaintiffs claim they entered into a bundled transaction with Defendants whereby they purchased both a phone and cellular service, and in doing so, were provided with a phone that was falsely advertised as "free" or substantially discounted, when in fact, they were required to pay the sales tax on the full retail value. (FAC at ¶¶ 23, 24, 25, 26 & 31.) Plaintiffs, in essence, contend putative class members were

injured by Defendants' "bait-and-switch" practices; that is, consumers were lured in with advertisements for free or deeply discounted phones, yet once in the store, they were charged sales tax based on the full retail value of the phone. (FAC ¶¶ 26 & 31.) Plaintiffs further contend that if Defendants were faithful to their advertisements, they would have absorbed the tax. Instead, according to Plaintiffs, Defendants illicitly shifted the tax burden to their customers ("fleeced" them) once such customers had taken the time and effort to respond to the deceptive advertisements. (*Id.*) Such allegations sufficiently allege an injury in fact.[4]

Plaintiffs, however, do not include *any* allegations in their FAC that they relied on Defendants' advertisements in entering into the transactions. While Plaintiffs meticulously describe the allegedly misleading advertisements (as later described in Plaintiffs' pleadings, a "bait-and-switch" leading to a "fleece"), none of the named Plaintiffs allege that they saw, read, or in any way relied on the advertisements; nor do they allege that they entered into the transaction *as a result* of those advertisements.

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[4] For these reasons, the Court also rejects Defendants' argument that Plaintiffs cannot allege false or deceptive advertising as a matter of law. *See* Defendants' Motion to Dismiss at § IV.A, where Defendants argue they were both required to calculate sales tax on the full retail price of the phones irrespective of any promotional discount and authorized to collect it from consumers. This argument, however, overlooks the essence of Plaintiffs' claim, *i.e.*, that Defendants engaged in "bait-and-switch" practices that deceptively and unfairly shifted the tax burden to consumers.

The language of the UCL, as amended by Proposition 64, makes clear that a showing of causation is *required* as to each representative plaintiff. ("Actions for any relief . . . shall be prosecuted exclusively . . . by any person who has suffered *injury in fact* and has lost money or property *as a result* of such unfair competition." Cal. Bus. & Prof.Code § 17204 (emphasis added)). Because Plaintiffs fail to allege they actually relied on false or misleading advertisements, they fail to adequately allege causation as required by Proposition 64. Thus, under §§ 17203 and 17204, Plaintiffs lack standing to bring their UCL and FAL claims. Plaintiffs' claims are dismissed with leave to amend to address these deficiencies.[5]

3. Plaintiffs' CLRA Claim

Defendants also seek dismissal of Plaintiffs' claim for damages under the CLRA because they failed to give proper notice to Defendants of their CLRA claim, as required by California Civil Code § 1782. Section 1782(a) provides:

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[5] Defendants also argue Plaintiffs improperly "attempt to pass off as a UCL restitution claim that is effectively a damages claim for misrepresentation." (Defendants' Reply at 7.) "[Plaintiffs] argue that Defendants alleged misrepresentations created an obligation to them to not charge taxes—which is either a contract or tort theory of *damages* for misrepresentation." (*Id.*) (emphasis added). Accordingly, since the UCL only permits claims for restitution, Defendants contend Plaintiffs' fail to state a claim for restitution under the UCL. Restitution, however, may be based on unjust enrichment. Plaintiffs therefore sufficiently allege Defendants were unjustly enriched by improperly shifting sales taxes to consumers.

> Thirty days or more prior to the commencement of an action for damages pursuant to this title, the consumer shall do the following:
>
> (1) Notify the person alleged to have employed or committed methods, acts, or practices declared unlawful by Section 1770 of the particular alleged violations of Section 1770.
>
> (2) Demand that the person correct, repair, replace, or otherwise rectify the goods or services alleged to be in violation of Section 1770.
>
> The notice shall be in writing and shall be sent by certified or registered mail, return receipt requested, to the place where the transaction occurred or to the person's principal place of business within California.

Cal. Civ.Code § 1782(a). Plaintiffs conceded that they failed to comply with the thirty day notice requirement set forth in § 1782, (*see* Plaintiffs' Opposition at 21), and through a separate filing have requested leave of court to "strike the premature allegation of damages without waiver and without prejudice based upon inadvertence and excusable neglect of counsel." (*Id.* at 22.) Thus, the only issue presented is whether the Court should dismiss Plaintiffs' CLRA damages claim with or without prejudice.

Defendants argue, based on *Von Grabe v. Sprint*, 312 F.Supp.2d 1285 (S.D.Cal.2003), that Plaintiffs' failure to provide adequate notice compels dismissal of the CLRA claim for damages with prejudice. Plaintiffs respond, however, by arguing that the facts in this instance are distinguishable from *Von Grabe*, because there has been no attempt to mislead the court by including the claim for damages, as the plaintiff did in *Von Grabe*; rather, the inclusion of

the request for damages was "mistakenly, prematurely included [in] the language requesting damages." (Plaintiffs' Opposition at 22.)

In *Von Grabe*, a cellular phone customer filed claims arising from an equipment replacement program fee charged by a cellular carrier. The plaintiff alleged, among other claims, a claim for damages under the CLRA. Ruling in the context of a motion to dismiss, the court dismissed the plaintiff's CLRA claim with prejudice because he failed to allege proper notice, as required by § 1782(a). In reaching its decision, the court relied on the California Court of Appeal opinion in *Outboard Marine Corp. v. Superior Court*, 52 Cal.App.3d 30, 124 Cal.Rptr. 852 (1975), which held that "*strict* application of the [notice] requirement was necessary" to achieve the goals of the CLRA. The court in *Outboard Marine* noted:

> *The purpose of the notice requirement of section 1782 is to give the manufacturer or vendor sufficient notice of alleged defects to permit appropriate corrections or replacements.* The notice requirement commences the running of certain time constraints upon the manufacturer or vendor within which to comply with the corrective provisions. The clear intent of the act is to provide and facilitate precomplaint settlements of consumer actions wherever possible and to establish a limited period during which such settlement may be accomplished. *This clear purpose may only be accomplished by a literal application of the notice provisions.*

Outboard Marine, 52 Cal.App.3d at 40-41, 124 Cal.Rptr. 852 (emphasis added).

Notably, neither *Outboard Marine* nor *Von Grabe* drew a distinction between inadvertence or willful disregard of the notice requirements. Both courts held that a claim for damages under the CLRA requires *strict* compliance with the notice requirements set forth in § 1782. This Court agrees. Strict adherence to the statute's notice provision is required to accomplish the Act's goals of expeditious remediation before litigation. Because Plaintiffs failed to provide notice to Defendants pursuant to § 1782(a), their claim for damages under the CLRA must be dismissed with prejudice.[6]

This result is not changed by the fact that Plaintiffs also brought a claim under the CLRA for injunctive relief. While § 1782(d) authorizes the filing of an action for injunctive relief *without* first providing notice to the vendor, the statute further directs that such an action may not be converted into an action for damages unless the consumer first complies with the notice provisions of § 1782(a). Accordingly, § 1782 scrupulously prohibits any action for damages unless its notice provisions are met. As stated, the Legislative goals would be eviscerated if consumers were allowed to sue for damages without first providing the statutorily mandated period for remediation.

Plaintiffs' claim for damages is therefore dismissed with prejudice. Plaintiffs' claim for injunctive relief stands, pursuant to § 1782(d).

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[6] This ruling, as with all rulings herein, applies only to the named Plaintiffs.

III.

CONCLUSION AND ORDER

For these reasons, the Court denies Defendants T-Mobile and Cingular's motion to compel arbitration. In addition, the Court grants without prejudice Defendants' collective motion to dismiss Plaintiffs' claims under the UCL and FAL. Plaintiffs shall file a second amended complaint within 20 days of the date this Order is stamped filed addressing the deficiencies noted herein. Finally, Defendants' motion to dismiss Plaintiffs' claims for damages under the CLRA is granted with prejudice.

IT IS SO ORDERED.

APPENDIX C

9 U.S.C. § 2. Validity, irrevocability, and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C § 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for

arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

APPENDIX D

T-Mobile Welcome Guide

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Section 4: Terms and Conditions

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3. Mandatory Arbitration: Dispute Resolution. YOU WILL FIRST NEGOTIATE WITH US IN GOOD FAITH TO SETTLE ANY CLAIM OR DISPUTE BETWEEN YOU AND US IN ANY WAY RELATED TO OR CONCERNING THE AGREEMENT, OR OUR PROVISION TO YOU OF GOODS, SERVICES, OR UNITS ("CLAIM"). YOU MUST SEND A WRITTEN DESCRIPTION OF YOUR CLAIM TO OUR REGISTERED AGENT (See Sec. 22). IF YOU DO NOT REACH AGREEMENT WITH US WITHIN 30 DAYS, INSTEAD OF SUING IN COURT, YOU AGREE THAT ANY CLAIM MUST BE SUBMITTED TO FINAL, BINDING ARBITRATION WITH THE AMERICAN ARBITRATION ASSOCIATION ("AAA") UNDER ITS PUBLISHED WIRELESS INDUSTRY ARBITRATION RULES, WHICH ARE A PART OF THE AGREEMENT BY THIS REFERENCE AND ARE AVAILABLE BY CALLING THE AAA AT 800-778-7878 OR VISITING ITS WEB SITE AT www.adr.org. You must serve our registered agent (See Sec. 22) with a notice of an arbitration in order to begin an arbitration. This agreement to arbitrate extends to claims that you assert against other parties, including without limit equipment manufacturers and dealers, if you also assert claims against us in the same proceeding. The Agreement involves interstate commerce and despite the choice of law provision in Sec. 25, the Federal Arbitration Act and federal arbitration law govern arbitrations under the Agreement. An arbitrator may only award as much

relief as a court having jurisdiction in the place of arbitration, limited to the same extent that a court would limit such relief and consistent with the provisions of the Agreement. An arbitrator may order injunctive or declaratory relief (so long as that injunctive or declaratory relief does not apply beyond your dealings with us) or summary judgment under applicable law. AAA has a fee schedule for arbitrations. You will pay your share of the arbitrator's fees except: (a) for claims less than $25, we will pay all arbitrator's fees and (b) for claims between $25 and $1000, you will pay $25 for the arbitrator's fee. You and we agree to pay our own other fees, costs and expenses including those for counsel, experts, and witnesses. Visit www.adr.org arbitrator fee information in hardship circumstances.

Neither you nor we may be a representative of other potential claimants or a class of potential claimants in any dispute, nor may two or more individuals' disputes be consolidated in one proceeding. While the prohibition on consolidated or classwide proceedings in this Sec. 3 will continue to apply: (a) you may take claims to small claims court, if they qualify for hearing by such court and (b) if you fail to timely pay amounts due, we may assign your account for collection and the collection agency may pursue such claims in court limited strictly to the collection of the past due debt and any interest or cost of collection permitted by law or the Agreement. YOU AND WE ACKNOWLEDGE AND AGREE THAT THIS SEC. 3 WAIVES ANY RIGHT TO A JURY TRIAL OR PARTICIPATION AS A PLAINTIFF OR AS A CLASS MEMBER IN A CLASS ACTION. IF A COURT OR ARBITRATOR DETERMINES THAT YOUR WAIVER OF YOUR ABILITY TO PURSUE CLASS OR REPRESENTATIVE CLAIMS IS

UNENFORCEABLE, THE ARBITRATION AGREEMENT WILL NOT APPLY AND OUR DISPUTE WILL BE RESOLVED BY A COURT OF APPROPRIATE JURISDICTION, OTHER THAN A SMALL CLAIMS COURT. SHOULD ANY OTHER PROVISION OF THIS ARBITRATION AGREEMENT BE DEEMED UNENFORCEABLE, THAT PROVISION SHALL BE REMOVED, AND THE AGREEMENT SHALL OTHERWISE REMAIN BINDING.

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[5/04]

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